

NO PROTEST RECEIVED
Release _____ District _____

Date 31 Dec 91

Surname _____

SEP 19 1991

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code [hereinafter "Code"]. We have determined that you fail to qualify for exemption under that section of the Code. Our reasons for this conclusion and the facts upon which it is based are explained below

You were incorporated _____, under the laws of the State of _____, for the following purposes: to foster and develop a favorable working relationship to promote decent safe and sanitary services or other benefits to low and moderate income persons, to lessen the burdens of government, to construct housing for low and moderate income persons, to borrow and raise money from public and private sources, and to be organized and operated for the purposes described in section 501(c)(3) of the Code.

You will (1) carry out and assist in carrying out one or more housing projects for low-income persons, (2) provide advisory services to agencies and non-profit sponsors related to the development of housing projects for low-income households, (3) sponsor and assist in sponsoring limited partnerships, primarily with non-profit organizations as general partners, and corporations as limited partners, and (4) develop low income housing qualifying under section 42 of the Code. Your services and activities include: assistance in evaluating a project's financial feasibility, identification of project funding sources, assistance related to application preparation and submission, and assistance in obtaining and monitoring competent contractors, architects, property managers and others. For these services, you expect to charge fees in relation to development costs of the project undertaken. You will also take management and administrative fees. Your trustees are your sole members.

You are presently the parent company of [REDACTED], which is the managing partner of [REDACTED]. [REDACTED] is presently constructing a [REDACTED] apartment complex for persons whose annual income is at or below sixty percent of the area median income for [REDACTED]. Additionally, you represent that the project is to be built in an area that is economically depressed by federal standards.

Pursuant to your purposes you have solicited and obtained funds from the public to promote your charitable purposes. You have obtained over [REDACTED] dollars, which you will provide on a subordinated, non-recourse, low-interest basis to the limited partnership. More specifically, you will provide a second mortgage in an amount exceeding [REDACTED] dollars to the limited partnership; these funds will be lent to the limited partnership at [REDACTED] per cent interest. "Minimal" interest payments will be made annually for [REDACTED] years; the remaining interest will accrue and will be due, with the initial principal balance, in the [REDACTED] year. You will also provide a third mortgage to the limited partnership in the amount of [REDACTED] dollars at an interest rate of [REDACTED] per cent. "Minimal" payments of interest will be required with the remainder accruing and added to the principal balance, which will be due in the [REDACTED] year. Some of these two sets of funds must be lent to a limited partnership created for the purpose of owning and operating the project, here [REDACTED] [hereinafter "limited partnership"].

Sections 501(a) and 501(c)(3) provide for the exemption from federal income taxation of those organizations organized and operated exclusively for religious, charitable, and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order to be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for an exempt purpose only if the organization engages primarily in activities that accomplish one or more exempt purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Additionally, an organization is not organized or operated exclusively for one or more exempt purposes, unless it serves a public rather than a private purpose. Treas. Reg. section 1.501(c)(2)-1(d)(1)(ii).

In Rev. Rul. 72-369, 1972-2 C.B. 245, the taxpayer was an organization that had been formed to provide managerial and consulting services to nonprofit organizations to improve the administration of their charitable programs. The organization would enter into agreements to furnish managerial and consulting services on a cost basis. The services consisted of advising organizations on specific methods of operation. The ruling held that the provision of managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were carried on at cost and limited to non-profit organizations was not sufficient to characterize the activity as charitable under section 501(c)(3).

Your services and activities include: assistance in evaluating a project's financial feasibility, identification of project funding sources, assistance related to application preparation and submission, and assistance in obtaining and monitoring competent contractors, architects, property managers and others. These services and activities constitute consulting. Accordingly, you are analogous to the organization in Rev. Rul. 72-369, supra, because you provide a service that is commercially available, viz., consulting, and you provide this service for an amount that is commensurate with the development costs of the project undertaken. Consulting is a substantial part of your activity and purpose.

Additionally, you provide low interest loans to the limited partnership. The benefit of the foregone interest inures to the benefit of the limited partnership. It is true that you are required to lend some of the publicly derived funds to the limited partnership. However, the reach of such requirement does not explain why the loan must be below market. It is also true that such loan helps insure the economic vitality of the project, and, thus, promotes the social welfare. But this reasoning proves too much. The economic benefit of the low interest loan directly accrues to the limited partnership, and, therefore, to the benefit of the investors. You will not directly benefit from the low interest loans. And only incidentally does the project benefit. Finally, that this was a business decision cannot justify the scale of the private benefit that inures to the benefit of the investors, and the poverty of benefit that accrues directly to social welfare.

In Better Business Bureau v. Commissioner, 326 U.S. 279 (1945), the Supreme Court determined that while some activities of the organization under consideration were educational, a substantial purpose of the organization was to promote business; thus, the organization was not operating exclusively for educational purposes.

Thus, while it may be true that you somehow promote social welfare or lessen the burdens of government, you have a substantial commercial purpose, see Rev. Rul. 72-369, and you promote private benefit to an impermissible extent, Treas. Reg. section 1.501(c)(3)-1(d)(1)(ii).

Accordingly, we conclude that you fail to qualify for exemption from federal tax under section 501(c)(3) of the Code. You are required to file federal income tax returns on Form 1120.

You have the right to protest our ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

When submitting additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipt by placing the following symbols on the envelope: [REDACTED]. These symbols do not refer to your case but rather to its location.

Sincerely,

(signed) [REDACTED]

cc: DD, Atlanta ✓
Attn: EO Group

Chief, Exempt Organizations
Rulings Branch 2

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9/19/91